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CHARLES ELMORE

No. 288

In the Supreme Court of the United States

OCTOBER TERM, 1930

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

THOMPSON OIL & GAS COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE PETITIONER

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings of fact and the opinion of the Board of Tax Appeals (R. 9–14) are reported in 15 B. T. A. 993. The opinion of the Circuit Court of Appeals for the Tenth Circuit (R. 21–26) is reported in 40 F. (2d) 493.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 5, 1930. (R. 27.) An order extending the time for filing a petition for certiorari

ten days from the date of the order was signed by a Justice of this Court on July 3, 1930. (R. 29.) Petition for a writ of certiorari was filed July 11, 1930, and the writ was granted October 13, 1930. (R. 29.) Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, under Section 234 (a) (9) of the Revenue Act of 1918, in determining for any taxable year the capital value, recoverable through depletion allowances, of oil-mining properties acquired prior to March 1, 1913, there should be deducted from the March 1, 1913 value of the properties the amount of depletion actually *sustained* in earlier years or only so much of such depletion as was *allowable* as deductions in those years.

STATUTE AND REGULATIONS INVOLVED

These are set forth in the Appendix, pp 25–27, *infra*.

STATEMENT

The pertinent facts found by the Board of Tax Appeals are as follows:

The respondent owned an oil and gas mining lease which had been acquired prior to March 1, 1913. (R. 9.) On that date the recoverable oil in the reserve embraced by the lease was 278,000 barrels, and the value thereof was $156,645, or $0.56347 per barrel. (R. 9–10.)

From March 1, 1913, to December 31, 1915, the respondent extracted 162,717 barrels of oil, and at the unit rate mentioned *sustained* depletion in the amount of $91,686.15. (R. 10.) During this same period the total depletion *allowed* the respondent as deductions from gross income, under the Revenue Act of 1913, then in force, was $6,322.02.[1] (R. 11.)

In 1916 the respondent secured an extension of its lease at a cost of $30,000, as a result of which its oil reserve was increased 300,000 barrels. (R. 10.) At this time there remained of the original reserve 115,283 barrels, having a March 1, 1913, value of $64,958.85. By adding to this depleted March 1, 1913, value the cost of the extension of the lease, and by increasing the remaining oil reserves by the additional 300,000 barrels, the Commissioner found a new total recoverable reserve of 415,283 barrels, having a basic value or cost of $94,958.85, or $0.22866 per barrel. (R. 10.) There were no subsequent additions to the reserves.

In 1916 and 1917 the respondent produced 49,452 and 39,204 barrels of oil, respectively, on which it sustained depletion in the respective amounts of $11,307.69 and $8,964.39. During 1918 respondent produced 33,697 barrels of oil, upon which it sustained depletion in the amount of $7,705.16, deter-

[1] Under the Revenue Act of 1913 (p. 25, *infra*) the annual deduction allowed for depletion was restricted to 5% of the gross production of the respondent, which for the period in question totaled $126,440.44. (R. 10.)

mined at the unit rate of $0.2286 per barrel, which amount the Commissioner allowed as a deduction from gross income for 1918. (R. 10.) It is the depletion allowance for 1918 which is here in question. (R. 11.)

The respondent contended that the unit rate of depletion per barrel for 1918 should have been based upon the original March 1, 1913, value of the oil reserves plus the cost of the extension of the lease, and less only that portion of the depletion sustained in 1913, 1914, and 1915,[2] which was *allowed* to it as deductions (i. e., $6,322.02). The Commissioner, in determining the capital value of the total reserve upon which depletion for 1918 should be based, adopted the March 1, 1913, value of the reserve, plus the cost of the extension of the lease, less the full amount of the depletion *sustained* in the years 1913, 1914, and 1915 (i. e., $91,686.15), holding that the entire depletion sustained in these years should be deducted from the original March 1, 1913, value whether allowable as deductions or not.

The Board of Tax Appeals sustained the Commissioner. (R. 17.) Upon appeal the Circuit Court of Appeals, relying upon *United States* v. *Ludey*, 274 U. S. 295, held that in determining in

[2] No question is here raised as to the correctness of the amounts of depletion for 1916 and 1917 deducted by the Commissioner from the March 1, 1913, value in computing in 1918 the capital value of the recoverable reserves upon which the depletion allowance for 1918 was based.

1918 the value or cost of the reserves then recoverable through depletion allowances there should be deducted from the original March 1, 1913, value or cost only so much of the depletion sustained between March 1, 1913, and December 31, 1915 (i. e., $91,686.15), as was legally allowable as deductions during that period (i. e., $6,322.02) and, accordingly, reversed the decision of the Board. (R. 21–26.) This Court granted certiorari on October 13, 1930. (R. 29.)

SPECIFICATION OF ERRORS

The Circuit Court of Appeals erred in holding that the capital value in 1918 of oil-mining properties, acquired prior to March 1, 1913, recoverable through depletion allowances, is the March 1, 1913, value of the oil reserves, plus the cost of subsequent capital additions and minus only the amounts of depletion of the reserves in prior years which were allowed as deductions from gross income of such years.

SUMMARY OF ARGUMENT

Section 234 (a) (9) of the Revenue Act of 1918 provides that in the case of oil wells there shall be allowed as a deduction "a reasonable allowance for depletion," said allowance to be based upon the cost or March 1, 1913, value of the property, and to be computed "according to the peculiar conditions in each case," and under rules to be prescribed by the Treasury Department. Pursuant to this authority the Treasury Department promul-

gated Article 203 of Regulations 45 (1920 Edition), which provides that in the case of a lessee of oil property the capital remaining in any year recoverable through depletion and depreciation deductions is (1) the value as of the basic date of the lessee's equity plus (2) subsequent capital additions but minus (3) depletion and depreciation theretofore "sustained, whether legally allowable or not," from the basic date to the taxable year in question. The respondent's depletion allowance for 1918 was computed in strict compliance with this regulation. This regulation has been in substance reissued under each successive Revenue Act and has received legislative sanction through the repeated reenactment of the applicable portion of the 1918 Act. Accordingly it has the force and effect of law.

The annual allowance for depletion is not a matter of right but depends upon the legislative intent. The regulations under which the respondent's 1918 depletion deduction was allowed in the instant case was computed upon a theory which would ultimately restore to the respondent its capital assets as they existed when the 1918 Act became effective, and they therefore gave to the respondent the "reasonable allowance" specified in the statute. Congress did not intend in enacting the Revenue Act of 1918 to allow as deductions for depletion in 1918 that which it expressly refrained from granting as deductions under prior Acts.

United States v. *Ludey*, 274 U. S. 295, does not control the instant case. The *Ludey case* involved

the question of *gain or loss* upon a *sale* or final disposition of oil properties, whereas the instant case involves merely the annual depletion allowances to be made under the Revenue Act of 1918 *to an operating company*. In order to determine whether there has been a gain or loss upon the sale of capital assets, there must be withdrawn from the gross proceeds an amount sufficient to restore the capital value. Accordingly, it was necessary in the *Ludey case* to compute the depleted cost of the property sold by deducting from the original cost only the amount of depletion which had been allowable theretofore. Where, as in the instant case, the question depends on the capital value in 1918 of the remaining recoverable oil reserves, it is the depletion which has theretofore been actually *sustained*, whether allowable as deductions theretofore or not, which is determinative.

ARGUMENT

THE FULL AMOUNT OF DEPLETION SUSTAINED IN PRIOR YEARS MUST BE TAKEN INTO ACCOUNT IN COMPUTING THE RESPONDENT'S ALLOWANCE FOR DEPLETION IN 1918

The Commissioner of Internal Revenue and the Board of Tax Appeals, in determining the capital value (or cost) of the total oil reserves upon which the respondent's depletion allowance for 1918 should be based, adopted the March 1, 1913, value of the reserves, plus the cost of the extension of the lease, minus the amount of the depletion actually *sustained* in the years 1913 to 1917, inclusive,

holding that the entire depletion sustained in those years should be deducted from the original March 1, 1913, value whether allowable as deductions or not.[1] The depletion actually *sustained* in the years 1913, 1914, and 1915, during which period the Revenue Act of 1913 was in force, was $91,686.15. The depletion *allowed* the respondent in 1913, 1914, and 1915 was only $6,322.02, this amount being 5% of the respondent's gross production during this period, which was the maximum amount of depletion permitted as a deduction under the Revenue Act of 1913 (p. 25, *infra*). The respondent contends, as held by the court below, that in computing the capital value (or cost) of the oil reserves upon which the 1918 allowance should be based, the original March 1, 1913, value should not have been reduced by the amount of depletion *sustained* in 1913, 1914, and 1915, but only by the amount *allowed* by Congress as a deduction from gross income in those years (i. e., $6,322.02).

It is now well settled that a lessee of oil and mining properties is not entitled *as a matter of right* to make any annual deduction from gross income, by way of restoration of capital, on account of the extraction and sale of the mineral which produces the income. He is entitled only to the deduction granted by the statute. *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364, 373; *Von*

[1] See footnote 2, p. 4, *supra*.

Baumbach v. *Sargent Land Co.*, 242 U. S. 503; *Goldfield Consol. Mines Co.* v. *Scott*, 247 U. S. 126; *United States* v. *Biwabik Mining Co.*, 247 U. S. U. S. 116; *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103; *New Creek Co.* v. *Lederer*, 295 Fed. 433, 435 (C. C. A. 3rd), certiorari denied, 265 U. S. 581. See *Kentucky Tobacco Products Co.* v. *Lucas*, 5 F. (2d) 723, 728 (W. D. Ky.).[4] Accordingly, the question here involved is solely one of statutory construction.

Section 234 (a) (9) of the Revenue Act of 1918, page 26, *infra*, provides:

> SEC. 234. (a) That in computing the net income of a corporation * * * there shall be allowed as deductions:
>
> * * * * *
>
> (9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair

[4] Certain of these cases involved the Corporation Excise Tax Act of 1909, c. 6, 36 Stat. 112, but it has been held that the word "income" has the same meaning under the Sixteenth Amendment that it had under the 1909 Act. *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, 519.

> market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of costs up to that date: * * * such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. * * *

The statute thus provides: (1) that "a reasonable allowance" for depletion shall be made, based upon the cost or March 1, 1913, value of the property, and (2) that this allowance shall be made "according to the peculiar conditions in each case," and under rules and regulations prescribed by the Commissioner and the Secretary of the Treasury. The statute does not provide as a deduction the precise amount of the depletion. It does not expressly direct that the allowance must be such that it will, ultimately, return to the taxpayer precisely all, or any specified portion of, the capital investment. Nor does it attempt to prescribe how the annual allowance shall be computed; this obviously depends upon many variable factors which are impossible of exact ascertainment. Accordingly, Congress merely provided for a "reasonable allowance" to be made under rules and regulations prescribed by the Treasury Department.

Pursuant to this authority the Treasury Department on December 29, 1920 (T. D. 3107, 4 C. B. 187), promulgated Article 203 of Regulations 45 (1920 Edition), which provides (p. 27, *infra*):

ART. 203. *Capital recoverable through depletion deductions in the case of lessee.*—(a) In the case of a lessee, the capital remaining in any year recoverable through depletion and depreciation deductions is (1) the value as of the basic date of the lessee's equity in the property plus (2) subsequent allowable capital additions but minus (3) depletion and depreciation sustained, *whether legally allowable or not*, from the basic date to the taxable year. * * * (Italics ours.)

From the foregoing it will be seen that the respondent's depletion allowance for the taxable year in question was made *in exact compliance with the applicable regulations*. The respondent does not contend that the allowance made by the Commissioner for 1918 falls short of the actual amount of depletion sustained in 1918. It does not contend that the original March 1, 1913, value used was erroneous, and it is not denied that the reserve was actually depleted in 1918 in the amount which was allowed as a deduction in 1918. Its contention is that under the statute the respondent was entitled to a depletion deduction computed on a basis which will ultimately return to it, tax free, the full value of the capital assets *with which it started on March 1, 1913*, and therefore that in computing the 1918 allowance the original March 1, 1913, value should not have been reduced by the true amount of depletion which was sustained in earlier years but

only by that amount which Congress in those years permitted as a deduction. The contention of the respondent thus requires that the regulations promulgated by the Commissioner be set aside as not permitting "a reasonable allowance."

The statute imposed upon the Commissioner the specific duty of promulgating regulations which would afford a reasonable allowance for depletion. Section 203 of Regulations 45 (1920 Edition) was therefore promulgated, not as an interpretation of the law but as a supplement to it, under express legislative authority. The statute was designedly framed in general terms so as to permit the Department charged with its administration to establish its own method of effecting the legislative intention. It is well settled that regulations made by a department of government, addressed to and reasonably adapted to the enforcement of an Act of Congress, the determination of which is confided to such department, have the force and effect of law, if not unreasonable or inconsistent with the statute. *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 349; *United States* v. *Morehead,* 243 U. S. 607; *United States* v. *Birdsall,* 233 U. S. 223; *Boske* v. *Comingore,* 177 U. S. 459. And the interpretation of administrative officers expressed in such regulations will not be disturbed except for weighty reasons. *Brewster* v. *Gage,* 280 U. S. 327; *United States* v. *Moore,* 95 U. S. 760, 763.

The regulations in question have been in force since 1920. They have been repeated in substance in the regulations issued under each successive Revenue Act. (See Regulations 62, Art. 203, promulgated under the Revenue Act of 1921; Regulations 65, Art. 203, promulgated under the Revenue Act of 1924; Regulations 69, Art. 203, promulgated under the Revenue Act of 1926; Regulations 74, Art. 223, promulgated under the Revenue Act of 1928.) Even more significant is the fact that Congress, in the light of these regulations, has reenacted in each successive Revenue Act, in substantially the same language, the provision of the Revenue Act of 1918 here involved. (See Sec. 234 (a) (9) of the Revenue Act of 1921; Section 234 (a) (8) of the Revenue Act of 1924; Section 234 (a) (8) of the Revenue Act of 1926; Section 23 (l) of the Revenue Act of 1928.)

Numerous decisions of this Court have enunciated the rule that when Congress reenacts a statute which has received departmental construction, it is deemed to have given implied approval to such interpretation, since it is presumed to have legislated with knowledge of the construction adopted by the executive department. In other words, a departmental interpretation under such circumstances becomes a legislative interpretation, with the force and effect of law. *National Lead Co.* v. *United States*, 252 U. S. 140; *United States* v. *Hermanos y Compania*, 209 U. S. 337; *United States* v. *G. Falk & Brother*, 204 U. S. 143.

We submit that the regulations adopted by the Treasury Department are consistent with the legislative intent. They permit a depletion allowance computed on a basis which would ultimately restore to the respondent the full value of its capital assets as they existed when the Revenue Act of 1918 became effective. There is nothing in the 1918 Act which provides that all depletion sustained in any prior year which was not allowable as a deduction from gross income in such year should, in effect, be allowed as part of the depletion deductions in later years, so that when the asset is finally exhausted its full value as of March 1, 1913, must have been allowed as deductions from gross income. The language of the statute contains no suggestion of a desire to remedy an underallowance of depletion for prior years through an excessive allowance in 1918. The 1918 Act merely provides for "a reasonable allowance," and it is submitted that this can not be interpreted to mean more than a reasonable allowance based upon the exhaustion which actually occurs during the year for which the tax is determined.

In the years 1913 to 1915, inclusive, when $91,686.15 of depletion was actually sustained, the Revenue Act of 1913 limited (p. 25, *infra*) the annual depletion deduction to "not to exceed, in the case of mines, 5 per centum of the gross value at the mine of the output for the year for which the com-

putation is made."[5] The validity of this arbitrary limit was sustained in *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103. Since the decision of the court below authorizes an allowance in 1918 for depletion *actually sustained in earlier years*, the necessary effect of that decision is to give to the taxpayer in 1918 a deduction which the statute expressly prohibited him from taking in earlier years. Moreover, the effect of the decision below is to increase, in 1918, the value of the respondent's remaining reserve by the $85,000 (approximately) difference between the depletion sustained and the depletion allowed under the 1913 Act. Thus a value has been attributed to the remaining reserve in excess of its conceded value and a deduction is permitted in 1918 which was not sustained in that year. This is contrary to the accepted principle that losses are deductible only for the year in which sustained. *DeLoss* v. *Commissioner*, 28 F. (2d) 803 (C. C. A. 2nd), certiorari denied, 279 U. S. 840; *Burns* v. *Commissioner*, 31 F. (2d) 399 (C. C. A. 5th), certiorari denied, 280 U. S. 564. The taxpayer can not choose the year when he will claim a deduction. *Newman* v. *Commissioner*, 41 F. (2d) 743, 744 (C. C. A. 10th), No. 68, October Term, 1930, certiorari denied, October 13, 1930. *A fortiori*, he can not claim a deduction in a later year when Congress specifically withheld the right from him in the year which the depletion occurred.

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[5] No contention is made that this provision does not apply to oil and gas wells. It has always been so understood.

The court below recognized (R. 26) that its decision resulted in attributing an excessive value to the remaining reserves recoverable through depletion but thought that the instant case was controlled by *United States* v. *Ludey*, 274 U. S. 295. We submit that that case is not controlling here. The *Ludey case* involved the question of gain or loss upon a *sale* of oil properties. It was settled in *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179, that in order to determine whether there has been a gain or loss upon the sale of capital assets there must be withdrawn from the gross proceeds an amount sufficient to restore the capital value that existed at the beginning. Only the amount remaining is income. Accordingly it was necessary in the *Ludey case* to compute the depleted cost by deducting from the original cost only the amount of depletion which had been allowable theretofore. In determining *gain or loss* from a *sale* the taxpayer must get back his cost free of tax, and depletion enters into the calculation for the purpose of determining how much of his cost has already been returned to him. For this purpose the *sustained* depletion is not important. Therefore, this Court, in the *Ludey case*, decided that the original cost must be reduced only to the extent that it had already been recovered in the form of *allowable* depletion. But it does not follow that the same rule applies in this case, where the only question is what annual al-

lowance Congress intended a taxpayer engaged in the *operation* of an oil well to have as a deduction from gross income.

When, as in the *Ludey case*, the question to determine is how much of the capital has already been returned tax-free, the depletion which has been allowed is determinative, and the depletion which has been sustained is unimportant. But when, as in the instant case, the question is how much of the reserve remains, as of the beginning of any year, to be depleted over its remaining life, the depletion which has been allowed or allowable in earlier years is of no consequence. In order to determine what allowance respondent was entitled to in 1918 it was necessary to determine how much of its original reserve remained at the beginning of 1918. It is obvious that on that date the original March 1, 1913, value can only remain to the extent that it has not already *sustained* depletion. Accordingly, the applicable regulations require the original cost to be reduced by the amount of depletion already sustained whether theretofore allowed or not. We submit that they provide a "reasonable allowance." The rule for which the respondent contends would require that the 1918 value of the oil reserve be increased over its actual value by assuming that some of the oil which had been taken out in earlier years still remained in the reserve.

It is true that in the *Ludey case* this Court said (p. 301):

> The theory underlying this allowance for depreciation is that by using up the plant, a gradual sale is made of it.

This Court also said in that case (p. 303) "In essence, the deduction for depletion does not differ from the deduction for depreciation." Apparently it was these statements which led the court below to the conclusion that the *Ludey case* governed the instant case. We do not believe, however, that this Court meant in that case to hold literally that the extraction and sale of a barrel of oil from an oil reserve is *pro tanto* a sale of the oil reserve. It has been held that the receipts from an oil and gas lease are not gains from the sale of capital assets but rents or royalties subject to the income tax. *Berg* v. *Commissioner*, 33 F. (2d) 641 (Ct. of App., D. C.), *Hirschi* v. *United States*, 67 C. Cls. 637. And see cases cited at p. 9, *supra*. But even if the operation of oil properties is a piecemeal sale thereof, it does not follow that in determining the annual allowance for depletion the oil producer must of necessity get back his cost tax free when he sells a barrel of oil before any part of the purchase price is taxable. Because money received under a contract is, in a loose sense, a return of expenditures made in performing the contract, it does not become necessary first to restore the cost before any of the money received may be taxed as income. *Burnet* v. *Sanford & Brooks Co.*, No. 31, October Term, 1930, decided January 5,

1931. The arbitrary allowance of 5% of the gross value of the output for the year, which was made on account of depletion in the Income Tax Act of 1913 (p. 25, *infra*), was sustained by this Court in *Stanton* v. *Baltic Mining Co., supra,* against the contention that the allowance was wholly inadequate and caused the tax to be one upon property because of its ownership. The question is solely one of the legislative intent, and we submit it can not be demonstrated that the 1918 Act was intended to grant depletion allowances for depletion occurring during years when such allowances were expressly denied.

If it can be said that the regulations promulgated by the Commissioner produce a harsh result it may be pointed out that where the question is one of statutory construction arguments addressed to the economic wrong involved in the imposition of the tax are beyond judicial cognizance, even where the court may perceive hardship in taxing receipts as income without providing for deductions on account of the exhaustion of the property. *Brushaber* v. *Pac. R. R. Co.*, 240 U. S. 1; *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503, 525.

Moreover, even if we treat the sale of a barrel of oil as a partial sale of the oil reserve, to apply thereto in the instant case the so-called rule of the *Ludey case* would result in increasing the cost or basis of each barrel sold (for the purpose of determining gain or loss) in 1918 over its actual

cost or basis by reason of the fact that too low a cost or basis was taken for the units sold in earlier years. Such a result finds no justification in the statute.

The rule of the *Ludey case* was first written into the statute by Section 202 (b) (2) of the Revenue Act of 1924 (c. 234, 43 Stat. 253, U. S. C., Title 26, Sec. 933). That section provided in the case of the *sale* of property acquired prior to March 1, 1913, that the value on that date should be adjusted by the depletion previously "allowed." This provision has been repeated, in substance, in the later Revenue Acts, where, however, the word "allowable" is used. (See Section 202 (b) (2) of the Revenue Act of 1926, c. 27, 44 Stat. 9; Section 111 (b) (2) of the Revenue Act of 1928, c. 852, 45 Stat. 791.) But this provision only applies to *sales*. The fact that in the later Acts Congress left the section of the statute relating to the annual depletion allowance (Sec. 234 (a) (9)) substantially as it was in the 1918 and 1921 Acts indicates, we think, that Congress was content to have the rule prescribed by the regulations for computing the annual deductions for depletion continue in effect.

The computation made in the instant case by the Commissioner, pursuant to the regulations, reflects the exact situation with respect to respondent's oil reserve, both at the beginning and at the end of 1918. Unless it can be said that Congress intended

to make an allowance for 1918 and subsequent years which would take into account the limited depletion deduction provided for in the 1913 Act, it would seem that an allowance which is based on actualities is reasonable. In considering respondent's contention it must be remembered that we are dealing, not with any express statutory provision, but only with an asserted implication. The statute is unquestionably general enough to support the Commissioner's regulations, and before it can be said that they do not correctly interpret the Congressional purpose it must clearly appear that a "reasonable allowance" for 1918 contemplated a reduction of 1918 income by a belated allowance for depletion actually sustained in earlier years but denied by the statute then in effect.

In the court below the respondent relied upon Section 201 of Regulations 45 (p. 26, *infra*), which provides:

> ART. 201. *Depletion of mines, oil and gas wells; depreciation of improvements.*— * * *.
>
> The essence of these provisions of the statute is that the owner of mineral deposits, whether freehold or leasehold, shall within the limitations prescribed, secure through an aggregate of annual depletion and depreciation deductions the return of either (a) his capital invested in the property, or (b) the value of his property on the basic date, plus

subsequent allowable capital additions (see article 222), but not including land values for purposes other than the extraction of minerals.

There is no inconsistency between Article 201 and Article 203 (p. 27, *infra*). The capital value which Article 201 contemplates being returned to the taxpayer by annual depletion and depreciation deductions is, quite clearly we think, the *capital invested in the property remaining when the 1918 Act became effective*. So far as the instant case is concerned, this would seem to be made perfectly clear by Article 203, almost immediately following.

In the court below it was contended that beginning with the 1918 Act Congress has evidenced a purpose ultimately to return through depletion allowances the exact amount of the capital investment. Assuming that this is true, the capital value to be returned is that existing at the beginning of the year 1918. Moreover, the contention that a legislative intent exists ultimately to return the precise original capital investment tax free is negatived by the fact that the later Revenue Acts have provided for an arbitrary annual depletion allowance based upon a specific percentage of the gross income. (See Section 204 (c) (2) of the Revenue Act of 1926, U. S. C., Sup. III, Title 26, Sec. 936; Section 114 (b) (3) of the Revenue Act of 1928, U, S. C., Sup. III, Title 26, Section 2114.) Under

the 1926 and 1928 Acts the annual depletion allowance is permitted even where the depletion deductions in earlier years have in the aggregate equaled the original cost or March 1, 1913, value. (I. T. 2327, VI–1 C. B. 18; I. T. 2350 VI–1, C. B. 20.)

The court below held that the only "reasonable allowance" intended by the statute was one which would return to the taxpayer tax-free the original cost or March 1, 1913, value. The 1918 Act does not specifically so provide and the Revenue Act in force during 1913, 1914, and 1915 specifically limited the allowance. Congress during those years clearly had no intention to make provision for the return of the exact original cost or March 1, 1913, value. We submit that in enacting the Revenue Act of 1918 Congress did not intend to grant as deductions that which it had expressly refused to grant under the 1913 Act. As the 1918 Act was interpreted in the administrative regulations, the cost to be returned by the annual depletion allowances is only the cost remaining when the statute became effective. It can not be demonstrated, we submit, that Article 203 of Regulations 45, under which the Commissioner computed the respondent's depletion allowance for 1918 in the instant case, does not provide the "reasonable allowance" specified in the statute.

CONCLUSION.

We respectfully submit that the judgment of the Circuit Court of Appeals should be reversed.

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FEBRUARY, 1931.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

The Revenue Act of 1913 (c. 16, 38 Stat. 114, 167) provides in part:

> SECTION II. B.
>
> * * * * * * *
>
> That in computing net income * * * there shall be allowed as deductions: * * * sixth, a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business, not to exceed, in the case of mines, 5 per centum of the gross value at the mine of the output for the year for which the computation is made, * * *.

The Revenue Act of 1916 (c. 463, 39 Stat. 756, 767–768) provides in part:

> SEC. 12 (a) In the case of a corporation * * * such net income shall be ascertained by deducting from the gross amount of its income * * *.
>
> * * * * * * *
>
> Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including * * * (a) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; * * *.

The Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1077), provides in part:

> SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * * *
>
> (9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of costs up to that date: * * * such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. * * *

Regulations 45 (1920 Ed.), promulgated under the Revenue Act of 1918, provides:

> ART. 201. *Depletion of mines, oil and gas wells; depreciation of improvements.*—* * * The essence of these provisions of the statute is that the owner of mineral deposits, whether freehold or leasehold, shall within the limitations prescribed, secure through an aggregate of annual depletion and depreciation deductions the return of either (a) his capital invested in the property, or (b) the value of his property on the basic date, plus subsequent allowable capital additions (see article 222), but not including land values

for purposes other than the extraction of minerals.

* * * * *

ART. 203. *Capital recoverable through depletion deductions in the case of lessee.*—(a) In the case of a lessee, the capital remaining in any year recoverable through depletion and depreciation deductions is (1) the value as of the basic date of the lessee's equity in the property plus (2) subsequent allowable capital additions but minus (3) depletion and depreciation sustained, whether legally allowable or not, from the basic date to the taxable year. The capital recoverable through depletion is the total capital remaining less the sum recoverable through depreciation.

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